

Digital Assets: From Crypto to Compliance

Final Treasury Regulations Expand Tax Reporting on DeFi Digital Asset Transactions with Notice 2025-3 for Transitional Relief and Guidance

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On December 27, 2024, the U.S. Treasury Department (Treasury) and Internal Revenue Service (IRS) published final regulations on digital asset tax information reporting requirements for certain decentralized finance (DeFi) industry participants, which are scheduled to be published in the Federal Register on December 30, 2024. The final regulations implement the statutory amendments to broker reporting rules enacted as part of the Infrastructure Investment and Jobs Act of 2021 (Infrastructure Act).

Earlier this year, on July 9, 2024, Treasury and the IRS published in the Federal Register (89 FR 56480) final regulations (REG-122793-19) (TD 10000) regarding broker information reporting requirements specific to custodial digital asset trading platforms, digital asset hosted wallet providers, processors of digital asset payments (PDAPs) and persons that interact with their customers as counterparties to transactions. These regulations also finalized the rules for calculating the basis of digital assets¹. The July 2024 regulations reserved on finalizing the rules with respect to non-custodial (decentralized or DeFi) industry participants, because Treasury and IRS acknowledged that they needed additional time to consider the issues and comments that they received. The preamble to TD 10000 also indicated that the Treasury Department and the IRS intended to “expeditiously” issue separate final regulations with respect to these participants, which they have done now with the December 2024 regulations.

¹ These rules are set forth under Internal Revenue Code section 1001 for determining the amount realized in a sale, exchange, or other disposition of digital assets under section 1012.

This December 2024 regulations focus on a new category of broker that operates within the segment of the digital assets industry referred to as decentralized finance (DeFi). The DeFi industry offers services that include smart contracts, which are automatically executing software programs that perform a predetermined series of actions. Because of the automatic nature of this technology, no participant in the DeFi industry would take custody of any digital assets for customers participating in such transactions. This is why they were previously referred to as decentralized exchanges.

In the Preamble to the December 2024 regulations, Treasury and the IRS discussed the DeFi industry, definitions and the requirements for being in a position to know the identity of the customer and the nature of the transaction, the statutory authority to treat DeFi participants as brokers, and responses to the many constitutional questions received during the comment period.

Due to the complexity of the digital asset broker reporting regulations, Treasury and IRS determined that a phased-in approach would be appropriate. The July 2024 regulations require gross proceeds reporting generally for sales occurring on or after January 1, 2025, for custodial industry participants and basis reporting for sales occurring on or after January 1, 2026, (but only with respect to digital assets the customer acquired from and held with the same broker on or after January 1, 2026). In the December 2024 regulations, Treasury and the IRS recognize that DeFi brokers may not have systems in place to collect and store customer identifying information or contracts with third-party services providers to do the same. More, DeFi brokers may not have the capability to perform information reporting or to apply backup withholding, where applicable, and remit this tax to the IRS. As such, the December 2024 regulations apply to sales of digital assets occurring on or after January 1, 2027. The IRS intends to work closely with stakeholders to ensure the smooth implementation of the reporting rules, including the mitigation of penalties in the early stages of implementation for most but particularly egregious cases involving intentional disregard of these rules.

To meet these terms, the IRS issued Notice 2025-3 contemporaneously with the December 2024 regulations. This Notice provides the following transitional relief for DeFi industry participants:

- **Postponed backup withholding date to January 1, 2028.** Effective date for potential backup withholding obligations imposed under section 3406 for payments required to be reported by DeFi brokers on Forms 1099-DA, Digital Asset Proceeds from Broker Transactions, for sale transactions.
- **No backup withholding penalties for calendar year 2028.** The IRS will not assert penalties for a DeFi broker's failure to deduct, withhold, and pay any backup withholding tax with respect to calendar year 2028 that is caused by a decrease in the value of received digital assets between the time of the transaction giving rise to the backup withholding liability and the time the broker liquidates 24 percent of the received digital assets, provided the broker undertakes to effect that liquidation immediately after the transaction giving rise to the backup withholding liability.
- **Backup withholding does not apply to certain DeFi sale transactions effected in calendar year 2028.** For sale transactions effected in 2028 for customers that have opened accounts with the broker prior to January 1, 2028, backup withholding will not apply with respect to any payee that furnishes a TIN to the broker, whether or not on a Form W-9 in the manner required² provided the broker submits that payee's TIN to the IRS's TIN matching program and receives a response that the TIN furnished by the payee is correct.³

The backup withholding relief provided in Notice 2024-56, 2024-29 I.R.B. 64 (July 15, 2024), also applies to the DeFi industry.

² See Treas. Reg. §§31.3406(d)-1 through 31.3406(d)-5.

³ See §601.601(d)(2)

- Applies to digital asset sales effected by a DeFi broker under these final regulations where the reportable proceeds are a specified NFT.
- Backup withholding relief provided for PDAP sales effected by a PDAP will also be applicable to PDAP sales effected by a DeFi broker that is also PDAP.
 - This relief for PDAP sales, however, does not apply to the extent the sale is also another type of sale described in §1.6045-1(a)(9)(ii)(A) through (C), such as a sale of digital asset A for digital asset B, because §1.6045-1(a)(9)(ii)(D) provides that a sale that is a PDAP sale and another type of digital asset sale is not treated as a PDAP sale. Custodial brokers will be required to report certain sale and exchange transactions that take place beginning in calendar year 2025 on Form 1099-DA, Digital Asset Proceeds from Broker Transactions. Basis reporting will be required by certain brokers for transactions occurring on or after January 1, 2026.

Please refer our publication for the details of Notice 2024-56.

Next Steps

KPMG is in the process of preparing additional Information Reporting & Withholding Tax Services Alerts that detail the December 2024 regulations. Look for our publications in 2025 for updates.

Reference

The proposed regulations can be found as unpublished until December 30, 2024, in the Federal Register, [here](#) and as a .PDF [here](#).

Notice 2025-3 can be found [here](#).

Notice 2024-56 can be found [here](#).

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